BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
FIDELITY SAVINGS AND LOAN ASSOCIATION )

For Appellant: Karen N. Manning
Executive Vice President

Peter J. Shaw
Vice President/Controller

For Respondent: Bruce W. Walker
Chief Counsel

Jacqueline W. Martins
Counsel

## O P I N I O N

This appeal is made pursuant to section 26075 of the Revenue and Taxation Code from the actions of the Franchise Tax Board in denying to the extent of $30,364.67 and $14,794.69 the claims of Fidelity Savings and Loan Association for refund of franchise tax in the amounts of $52,461.91 and $32,911.92 for the income years 1965 and 1967, respectively, and pursuant to section 25666 from the action of the Franchise Tax Board on appellant's protest against a proposed assessment of additional franchise tax in the amount of $24,828.20 for the income year 1967.

Appeal of Fidelity Savings and Loan Association

Appellant, a savings and loan association, was organized in 1965 as an association which was the result of the merger of Beneficial Savings and Loan Association (BSL) and Delta Savings and Loan Association (DSL) with Fidelity Savings and Loan Association (FSL). In 1966, Transbay Federal Savings and Loan Association (TSL) was merged into appellant. PSL began doing business in California in 1927, BSL in 1955, DSL in 1959 and TSL in 1949.

In computing its franchise tax for the years 1965 and 1967, appellant determined its deductible additions to its bad debt reserve by using the .6 percent average bad debt loss experience factor of similar California associations during the years 1928 through 1947 (the statewide average loss factor).

In 1970, respondent issued notices of proposed assessment (NPA's) for income years 1965 and 1967. The NPA's were the result, in part, of respondent's complete disallowance of claimed deductions for additions to appellant's bad debt reserve. Appellant protested and then filed a claim for refund for 1967 in the amount of $32,911.92, on the basis of adjustments made during a federal audit. Appellant paid under protest the amount of the NPA for 1965 and respondent treated the protested payment as a claim for refund.

In 1973 and again in 1977, revised NPA's were issued for 1967, both based in part on the disallowance of appellant's addition to its bad debt reserve. At the same time as the 1977 revised NPA, respondent issued a notice of action denying that portion of appellant's 1965 claim for refund attributable to the use of a bad debt loss experience factor in excess of that determined by respondent to be permissible. Respondent also denied in part appellant's claim for refund for 1967, apparently agreeing to the federal audit adjustments, but offsetting that amount with the disa-llowed bad debt reserve addition and certain loan fee adjustments which are not in issue here. During the course of this appeal, respondent has recomputed appellant's addition to its bad debt reserve, resulting in a tax reduction for 1965 which respondent is prepared to refund to appellant, and an increase in tax for 1967 which respondent will not attempt to collect.

The sole issue to be decided in this appeal is the proper bad debt loss experience factor for computing appellant's deductible addition to its bad debt reserve.

All other issues which have been raised during the years of appellant's protest have been resolved by the parties.

Revenue and Taxation Code section 24348 allows the deduction of "debts which become worthless within the income year: or, in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for -bad debts."

Respondent adopted California Administrative Code, title 18, regulation 24348(a) (hereinafter regulation 24348(a)), which applies exclusively to savings and loan associations for income years beginning after 1958 and before 1972. In pertinent part, the regulation states as follower

> (3) Rules Governing Use of Reserve Method. In determining the ratio of losses to outstanding loans for income years, beginning after December 31, 1958, a moving average is to be employed on a basis of 20 years experience, including the income year. . . . However, in lieu of the moving average experience factor an association may use an average experience factor based on any 20 consecutive years after the year 1927; provided, that for any 20-year period selected the association must use its own bad debt loss experience for the years that it was in existence during the period selected and the average bad debt loss of similar associations located in this State for such years as are necessary to complete the 20-year period. Associations which have not been in existence 20 years, see subparagraph (3)(ii). . .
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> (ii) A newly organized association or an association which arises as the result of a merger, consolidation or the acquisition of substantially all of the assets of a predecessor association without sufficient years' experience for computing an average as provided for above will be permitted to set up a reserve commensurate with the average experience of other similar associations with respect to the same type of loans. If such association has not been in existence during all or part of either of the 20-year periods, described at the beginning of this paragraph,

> it must use an average bad debt loss experience factor consisting of its own bad debt losses during the years for the period selected plus the average bad debt losses of similar associations located in this State for such years as are necessary to complete either of the 20-year periods selected. The average bad debt losses of such associations for the years 1928 to 1947, inclusive, has [sic) been determined by the Franchise Tax Board to be 0.6 percent. The average bad debt loss for each year from 1928 to 1947, inclusive is as follows:
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> The statewide average loss allowance is applicable for all income years beginning after December 31, 1958. ... In determining the average experience of similar associations the experience of associations which have ceased operations prior to the effective date of this regulation was disregarded. However, if such association was operated by a successor association as the result of a merger, consolidation or transfer of substantially all of the assets of its predecessor, the average experience of the acquired association with respect to the same type of loans was combined with the average experience of the successor association.

Appellant contends that its use of the statewide average loss factor was proper under subdivision (3)(ii) since it was "an association which [arose] as the result of a merger, consolidation or the acquisition of substantially all of the assets of a predecessor association without sufficient years' experience for computing an average . . . ."

Respondent asserts that where there is a merger of several predecessor associations, the bad debt loss experience factor is determined by combining the bad debt loss experiences of all predecessor associations for the years they were in existence during the 20-year period selected.

In Appeals of Home Savings and Loan Association, et al., decided by this Board on July 6, 1967, we stated that "a meaningful loss' experience in the case of

an association which is an amalgamation of previously existing associations may be achieved, logically, by combining the loss experience of all." We have consistently approved this method of determining the appropriate bad debt loss experience factor in previous opinions (See Appeal of Peninsula Savings and Loan Association, Cal. St. Bd. of Equal., Jan. 2, 1974; Appeal of People's Federal Savings and Loan Association, Cal. St. Bd. of Equal., Feb. 6, 1973; Appeal of American Savings and Loan Association, Cal. St. Bd. of Equal., May 4, 1970; and Appeal of The United Savings and Loan Association, Cal. St. Bd. of Equal., Nov. 19, 1968), and we believe that those opinions are controlling here. We conclude that the bad debt experience factor determined by respondent, using a combination of the loss experiences of all of appellant's predecessors, is proper for determining appellant's deductible addition to its bad debt reserve.

Appeal of Fidelity Savings and Loan Association

## O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the actions of the Franchise Tax Board in denying, to the extent of $30,364.67 and $14,794.69, the claims of Fidelity Savings and Loan Association for refund of franchise tax in the amounts of $52,461.91 and $32,911.92 for the income years 1965 and 1967; respectively, and pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Fidelity Savings and Loan Association against a proposed assessment of additional franchise tax in the amount of $24,828.20 for the income year 1967, be and the same are hereby modified to reflect the concessions made by respondent. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 18th day of August, 1980, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member